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Bankruptcy

by W. Homer Drake, Jr.*

and

Michael M. Duclos**

I. INTRODUCTION

During 1995, the United States Court of Appeals for the Eleventh Circuit decided seventeen cases in the area of bankruptcy law. These decisions covered a wide variety of issues arising under the Bankruptcy Code,¹ and one decision even concerned a case under the old Bankruptcy Act of 1898 ("Bankruptcy Act").² This article is a survey of the bankruptcy decisions rendered by the Eleventh Circuit in 1995.

II. DISPOSITION OF SURPLUS FUNDS

The Eleventh Circuit was faced with the unique problem of deciding the disposition of unclaimed funds stemming from a Chapter XI case under the old Bankruptcy Act³ in Georgian Villa, Inc. v. United States (In re Georgian Villa, Inc.).⁴ The debtor Georgian Villa, Inc., a nonprofit corporation which had built and operated a hospital, filed for bankruptcy under the Bankruptcy Act in 1977.⁵ While in bankruptcy, its property was sold at a price in excess of the corporation’s debt.⁶ Once all


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3. Id.
4. 55 F.3d 1561 (11th Cir. 1995).
5. Id. at 1561.
6. Id.
 administrative costs and previously undiscovered claims had been satisfied, a surplus of approximately $300,000 remained. In 1991, Georgian Villa remained dormant, but reactivated itself in 1991. In 1992, it filed a motion in the bankruptcy court for payment of the surplus funds to the debtor in accordance with 28 U.S.C. § 2042. The bankruptcy court, finding that Georgian Villa was no longer a viable corporation due to its period of dormancy and lack of shareholders, exercised its equitable powers and ordered that the surplus funds be paid into the treasury of the United States. Georgian Villa appealed, but the district court affirmed.

The Eleventh Circuit noted that the purpose of the bankruptcy system, at least under the Bankruptcy Act, was to make the debtor's property available to its creditors, while returning to the debtor any surplus that may remain at the end. The court also pointed out that under the former 11 U.S.C. § 106, a bankruptcy court was to disburse surplus funds in accordance with 28 U.S.C. § 2042. In effect, section 2042 stated that any claimant entitled to unclaimed funds could petition a court to direct payment of such funds. Georgian Villa relied upon these statutory provisions to argue it was entitled to the money. In contrast, the United States claimed that the bankruptcy court properly

7. Id. at 1561-62.
8. Id. at 1562.
9. Id. Section 2042 provides in pertinent part:
No money deposited under section 2041 of this title shall be withdrawn except by order of court. In every case in which the right to withdraw money deposited in court under section 2041 has been adjudicated or is not in dispute and such money has remained so deposited for at least five years unclaimed by the person entitled thereto, such court shall cause such money to be deposited in the Treasury in the name and to the credit of the United States. Any claimant entitled to any such money may, on petition to the court and upon notice to the United States Attorney and full proof of the right thereto, obtain an order directing payment to him.
10. 55 F.3d at 1562.
11. Id.
12. Because Georgian Villa's bankruptcy case was administered under the Bankruptcy Act, the Eleventh Circuit relied primarily on the law and commentary that existed prior to the enactment of the Bankruptcy Code in making its decision in this case. Id. at 1563-64.
13. Id. at 1562 (quoting 3A COLLIER ON BANKRUPTCY ¶ 66.03, at 2328 n.8 (14th ed. 1971)).
15. 55 F.3d at 1562.
17. 55 F.3d at 1562.
exercised its equitable jurisdiction to prevent those persons controlling Georgian Villa from receiving a windfall.\textsuperscript{18}

The Eleventh Circuit was unpersuaded by the government's argument. The use of a bankruptcy court's equitable powers to disregard the corporate entity and distribute unclaimed funds to another party is appropriate only in situations where the corporate debtor is no longer in existence.\textsuperscript{19} Such was not the case with Georgian Villa. Under Georgia law, a corporation's certificate of existence constitutes prima facie evidence that the corporation continues to exist.\textsuperscript{20} Georgian Villa had such a certificate, and the court found absolutely nothing in the record to rebut the evidence of its existence.\textsuperscript{21}

The fact that Georgian Villa lay dormant for well over a decade was of no consequence to the Eleventh Circuit.\textsuperscript{22} As all of the corporate assets were in the hands of the bankruptcy trustee, "Georgian Villa had little choice but to lay dormant until the resolution of its Chapter XI proceedings."\textsuperscript{23} Once the case had been fully administered, however, Georgian Villa was entitled to receive the remaining funds and resume operations.\textsuperscript{24}

\section*{III. CLAIMS: IDENTIFYING FUTURE CLAIMANTS}

The Eleventh Circuit was faced with the problem of defining what constitutes a "claim" within the meaning of section 101(5) of the Bankruptcy Code\textsuperscript{25} in the case of \textit{Epstein v. Official Committee of Unsecured Creditors (In re Piper Aircraft Corp.)}.\textsuperscript{26} Piper Aircraft was a manufacturer and distributor of general aviation aircraft and parts.\textsuperscript{27} After it filed for Chapter 11 bankruptcy, the bankruptcy court appointed David G. Epstein as the legal representative of the class of future claimants who might assert postconfirmation product liability claims

\begin{itemize}
  \item \textsuperscript{18} Id. Obviously, the United States was not concerned about the "windfall" the government would receive if the surplus funds were to be paid into the treasury.
  \item \textsuperscript{19} Id. at 1563.
  \item \textsuperscript{20} Id. (citing to O.C.G.A. § 14-2-128 (1994)).
  \item \textsuperscript{21} Id.
  \item \textsuperscript{22} Id.
  \item \textsuperscript{23} Id. The Eleventh Circuit panel seems to have viewed the reasoning of the bankruptcy and district courts as having put Georgian Villa into a catch-22 situation. According to the lower courts, Georgian Villa needed to be an active corporation in order to be entitled to the surplus funds. Unfortunately, Georgian Villa first needed the surplus funds before it could once again be an active corporation.
  \item \textsuperscript{24} Id.
  \item \textsuperscript{26} 58 F.3d 1573 (11th Cir. 1995).
  \item \textsuperscript{27} Id. at 1575.
\end{itemize}
against Piper Aircraft.\textsuperscript{28} Epstein then filed a proof of claim on behalf of the future claimants in the amount of $100,000,000, after which the Official Committee of Unsecured Creditors and Piper Aircraft filed objections.\textsuperscript{29} They objected on the ground that the future claimants did not hold section 101(5) claims against Piper Aircraft.\textsuperscript{30} The bankruptcy court sustained the objections,\textsuperscript{31} and the district court affirmed.\textsuperscript{32}

On Epstein's further appeal, the Eleventh Circuit had to decide what test to use to determine whether a party holds a claim pursuant to section 101(5). Epstein argued for the application of the "conduct" test, under which "a right to payment arises when the conduct giving rise to the alleged liability occurred."\textsuperscript{33} Under this view, the conduct giving rise to claims would be Piper Aircraft's prepetition manufacture, design, and sale of allegedly defective aircraft.\textsuperscript{34} Since Piper Aircraft performed these acts prepetition, all potential victims, even though currently unidentifiable, would be future claimants holding claims pursuant to section 101(5).\textsuperscript{35} The Committee and Piper Aircraft rejected this view, as did the bankruptcy and district courts, and argued in favor of the "prepetition relationship" test instead.\textsuperscript{36} This test "requires some prepetition relationship, such as contact, exposure, impact, or privity, between the debtor's prepetition conduct and the claimant in order for the claimant to hold a § 101(5) claim."\textsuperscript{37} Under this test, future claimants would not hold a claim, since they had no prepetition contact with Piper Aircraft.\textsuperscript{38}

After considering both views, the Eleventh Circuit agreed that the lower courts had properly applied the "prepetition relationship" test.\textsuperscript{39} Nevertheless, the court was not completely satisfied with the adoption

\textsuperscript{28} Id.
\textsuperscript{29} Id.
\textsuperscript{30} Id.
\textsuperscript{33} 58 F.3d at 1576-77.
\textsuperscript{34} Id. at 1577.
\textsuperscript{35} Id.
\textsuperscript{36} Id.
\textsuperscript{37} Id. (internal quotation marks omitted).
\textsuperscript{38} It is worth noting that some courts have used a third "accrued state law claim" test to determine the existence of a claim under section 101(5). This theory states that no claim exists in bankruptcy until it has accrued under state law. Although no party espoused such a view in this case, the Eleventh Circuit specifically rejected it. \textit{Id.} at 1576 n.2.
\textsuperscript{39} Id. at 1577.
of this view, concluding that some modification was necessary to reflect claims arising postpetition but prior to confirmation:

We therefore modify the test used by the district court and adopt what we call the "Piper test" in determining the scope of the term claim under § 101(5): an individual has a § 101(5) claim against a debtor manufacturer if (i) events occurring before confirmation create a relationship, such as contact, exposure, impact, or privity, between the claimant and the debtor's product; and (ii) the basis for liability is the debtor's prepetition conduct in designing, manufacturing and selling the allegedly defective or dangerous product.

Under this test, the future claimants in Piper Aircraft failed to present a claim recognizable in bankruptcy because there was no preconfirmation relationship with or exposure to Piper Aircraft and its allegedly defective products. Therefore, the Eleventh Circuit affirmed the result reached by the lower courts.

IV. THE AUTOMATIC STAY AND ADEQUATE PROTECTION PAYMENTS

The Eleventh Circuit reached an important decision affecting the rights of oversecured creditors in Orix Credit Alliance, Inc. v. Delta Resources, Inc. (In re Delta Resources, Inc.). It concluded that an oversecured creditor was not entitled to receive periodic cash payments for accruing postpetition interest as part of adequate protection under section 362(d)(1) of the Bankruptcy Code in order to preserve the value of its equity cushion. Orix Credit Alliance, an oversecured creditor of the Chapter 11 debtor Delta Resources, had obtained an order from the district court that it was entitled to receive such interest payments. The district court reached this result by relying on the Supreme Court's decision in United Savings Association v. Timbers of Inwood Forests Associates, Ltd., which held that section 506(b) of the

40. Id. This modified test was, in fact, enunciated by the bankruptcy court in another decision arising from the Piper Aircraft bankruptcy. Id. at 1577 n.5 (citing In re Piper Aircraft Corp., 169 B.R. 766 (Bankr. S.D. Fla. 1994)).
41. Id. at 1578.
42. Id.
44. 11 U.S.C. § 362(d)(1) (1993). Under this provision, a creditor may obtain relief from the automatic stay for lack of adequate protection of the creditor's interest in its collateral. Id.
45. 54 F.3d at 730.
46. Id. at 725. The bankruptcy court had concluded that Orix was entitled to receive only payments reflecting the collateral's depreciation. Id. at 724.
Bankruptcy Code authorized postpetition interest payments to oversecured creditors only. The Eleventh Circuit, however, reversed the district court. While it agreed that an oversecured creditor had the right to receive postpetition interest on its claim under section 506(b), the court noted that determination of a creditor's secured status comes near the end of a bankruptcy case while the matter of adequate protection is made at the inception of the case. With this in mind, the court concluded that:

11 U.S.C. § 506(b), providing for postpetition interest on oversecured claims, read in pari materia with 11 U.S.C. § 362(d)(1), concerning conditioning the automatic stay on adequate protection, and 11 U.S.C. § 502, regarding the allowance of claims, requires that the payment of accrued postpetition interest to an oversecured creditor await the completion of reorganization or confirmation of the bankruptcy case. Consequently, an oversecured creditor is not entitled to postpetition interest payments as adequate protection for its interest in collateral. Adequate protection of a creditor's interest in property as authorized in section 362(d)(1) encompasses the decline in the value of the collateral only. It does not, as the district court held, require protection of the creditor's interest in maintaining its equity cushion.

V. DISCHARGE AND DISCHARGEABILITY

A. Tax Liabilities

In the case of Haas v. IRS (In re Haas), the Eleventh Circuit visited the issue of whether, pursuant to section 523(a)(1)(C) of the Bankruptcy Code, certain federal taxes owed by a debtor were excepted from discharge. Thomas Haas had failed to pay his income and employment taxes owed to the Internal Revenue Service between 1977 and

49. 54 F.3d at 716 (citing 484 U.S. at 372-73).
50. Id. at 730.
51. Id. at 729-30.
52. Id. at 730.
53. Id.
54. Id.
55. 48 F.3d 1153 (11th Cir. 1995).
56. 11 U.S.C. § 523(a)(1)(C) (1993). The provision excepts from discharge any tax debt "with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax." Id.
57. 48 F.3d at 1154.
1985. While he filed accurate tax returns for the years in issue, he chose instead to pay his personal and business debts rather than his taxes. Once in bankruptcy, Haas commenced an adversary proceeding seeking a determination of the dischargeability of his federal tax liabilities. The bankruptcy court found that Haas' failure to pay the taxes did not amount to an affirmative attempt to evade or defeat the taxes. On appeal, however, the district court reversed, concluding in the process that Haas' knowing failure to pay the taxes constituted a willful attempt to evade and defeat his federal tax liabilities.

Because the facts of the case were virtually undisputed, the Eleventh Circuit's decision in Haas turned on the legal interpretation of the meaning of section 523(a)(1)(C). The IRS argued that the plain meaning of the phrase "willfully attempted in any manner to evade or defeat such tax" encompasses a debtor's knowing and willing failure to pay his tax liabilities. The Eleventh Circuit, however, found this plain meaning interpretation problematic, since it would result in virtually all tax debts being nondischargeable. As a result, the exception of section 523(a)(1)(C) would "swallow the general rule" allowing the discharge of tax liabilities. Furthermore, it would contravene the Bankruptcy Code's purpose of allowing a fresh start to the honest but unfortunate debtor.

58. Id.
59. Id.
60. Id.
61. Id.
63. 173 B.R. at 759.
64. 48 F.3d at 1155.
66. 48 F.3d at 1155.
67. Id.
68. Id. at 1155-56.
69. Id. at 1156 (citing to Grogan v. Garner, 498 U.S. 279, 285 (1991), and In re Miller, 39 F.3d 301, 304 (11th Cir. 1994)). With respect to a debtor's honesty, the court notes as follows:

Under the IRS's interpretation of section 523(a)(1)(C), the only honest debtor would be a debtor who is wholly unaware of her debt to the IRS. However, she is also an honest debtor who, fully cognizant of the debt that she owes to the IRS, uses her income to pay other debts instead. Her failure to pay the IRS is the result of not dishonesty but of the defining characteristic of all debtors—honest and dishonest, alike—insufficient resources to honor all of her obligations. That [Haas] decided to use his limited funds to satisfy obligations other than his properly acknowledged income taxes does not render him a dishonest debtor, simply a debtor.
Having concluded that the IRS's plain meaning argument would subvert the purposes underlying the Bankruptcy Code, the court in Haas undertook an analysis of relevant provisions of the Internal Revenue Code to interpret the ambiguity left by section 523(a)(1)(C). As a result of its search, the court found four places in the tax code where Congress had made a distinction between evasion of a tax and evasion of payment of a tax. These tax provisions were virtually identical in language to section 523(a)(1)(C) in that they made references to willfully attempting in any manner to evade or defeat the particular tax. Unlike section 523(a)(1)(C), however, the tax provisions added the phrase "or payment thereof." The addition of this phrase was critical. It showed that Congress knew how to include language in a law to make it applicable to the payment of the tax itself, as compared to merely evading or defeating the tax. Because the language of section 523(a)(1)(C) makes reference only to attempts to evade or defeat the tax, the Eleventh Circuit declined to conclude that Congress intended the failure to pay taxes, without more, would also result in the debt being excepted from discharge.

Later in the year, the Eleventh Circuit once again addressed a tax dispute within the context of bankruptcy in the case of United States v. Ryan (In re Ryan). Alvin and Sandra Ryan overpaid their income taxes for 1990 and requested that the IRS apply the overpayment to cover their unpaid taxes for 1989. Contrary to the Ryans' wishes, however, the IRS applied the overpayment to their 1986 liability.

After the Ryans filed for bankruptcy, they commenced an adversary proceeding to force the IRS to apply the excess 1990 tax funds to their 1989 liability. The Ryans argued that under the "voluntary payment
rule," the IRS must apply the 1990 overpayment as directed by the Ryanse. The Eleventh Circuit disagreed. The voluntary payment rule applied only in cases where a debtor makes a voluntary partial payment on assessed tax liability. The Ryans had not made a "partial payment" but instead had made an "overpayment." Such a distinction was important because under section 6402 of the tax code, the IRS is given the discretion to apply an overpayment as it sees fit. Thus, the IRS acted within its authority in applying the Ryans' 1990 overpayment to their 1986 liability, thereby making the Ryans liable for their 1989 unpaid income taxes.

B. Fraud: The Standard of Reliance

In the case of City Bank & Trust Co. v. Vann (In re Vann), the Eleventh Circuit answered the question of what standard of reliance a creditor must satisfy in a section 523(a)(2)(A) fraud dischargeability proceeding. In 1985, Edwin L. Vann entered into negotiations for a loan with City Bank & Trust. Vann initially provided the bank with information about his financial situation but, as negotiations went on, Vann's financial situation deteriorated. Nevertheless, Vann failed to update the bank on his finances, nor did the bank make any further inquiries. The parties eventually closed the loan, and later Vann filed a Chapter 11 bankruptcy petition. The bank responded to the admitted, however, that any 1989 liability would be excepted from discharge under 11 U.S.C. § 523(a)(1)(A), because it became due within three years before the filing of their bankruptcy petition. Their overpayment of taxes in 1990 exceeded the amount they owed for 1989. Thus, if the court forced the IRS to apply the overpayment to cover the Ryans' failure to pay in 1989, there would be no income tax debt remaining for 1989. Id. at 1517-18.

78. Id. at 1523. Under the IRS's own "voluntary payment rule," the taxpayer may direct how the payment is to be applied by the IRS. Id.
79. Id. at 1522-23.
80. 26 U.S.C. § 6402 (1995). This statute states in relevant part that "the Secretary . . . may credit the amount of such overpayment, including any interest allowed thereon, against any liability in respect of an internal revenue tax on the part of the person who made the overpayment." Id.
81. 64 F.3d at 1523.
82. Id. at 1524.
83. 67 F.3d 277 (11th Cir. 1995).
84. 11 U.S.C. § 523(a)(2)(A) (1993). This provision excepts from a debtor's discharge any debt obtained by "false pretenses, a false representation, or actual fraud." Id.
85. 67 F.3d at 277.
86. Id. at 279.
87. Id.
88. Id.
89. Id.
bankruptcy by commencing an adversary proceeding seeking to have its claim declared excepted from Vann’s discharge for fraud under section 523(a)(2)(A), arguing that Vann had fraudulently concealed the true nature of his finances. The bankruptcy court, with the district court later affirming, concluded that under the provisions of this section, the creditor must prove that it reasonably relied on the debtor’s representations, but that the bank failed to meet that standard.

On further appeal, the Eleventh Circuit reversed after concluding that the lower courts had held the bank to the wrong standard of reliance. The court reached this conclusion by first considering the statutory language of section 523(a)(2). Significant was the fact that subsection (B) of this section requires that a creditor’s reliance be reasonable, but no such mention of reasonable reliance is made in subsection (A). The court then deduced from the exclusion of the reasonable reliance standard in subsection (A) that Congress intended that a standard different from that in subsection (B) apply. Because the legislative history was silent as to what standard should apply in 523(a)(2)(A), the court looked to common law. Under common law, a victim of fraud is entitled to recovery if his reliance on the debtor’s misrepresentations was justifiable. The justifiable reliance standard is a more subjective approach than reasonable reliance in that it looks to the creditor’s “own capacity and the knowledge which he has, or which may fairly be charged against him from the facts within his observation in the light of his individual case.” In view of this common law approach, the Eleventh Circuit adopted the justifiable reliance standard for section 523(a)(2)(A) fraud discharge cases. Because this standard is more

90. Id.
91. Id.
92. Id. at 284.
93. 11 U.S.C. § 523(a)(2)(B)(iii) (1993). This subsection excepts from a debtor’s discharge debts incurred through the use of false financial statements, and it specifically requires that the creditor’s reliance on the statement be reasonable. Id.
94. 67 F.3d at 281.
95. Id. at 282.
96. Id.
97. Id. at 283 (citing to RESTATEMENT (SECOND) OF TORTS § 537 (1977) and W. PAGE KEETON, PROSSER & KEETON ON TORTS § 108, at 749 (5th ed. 1984)).
98. Id. (quoting W. PAGE KEETON, PROSSER & KEETON ON TORTS § 108, at 751 (5th ed. 1984)).
99. Id. The Eleventh Circuit noted that the circuit courts are split on this question and use three standards of reliance: (1) reasonable reliance, (2) justifiable reliance, and (3) actual reliance. Id. at 280. Eight months after the Eleventh Circuit issued its decision in Vann, the Supreme Court resolved the conflict among the circuits by concluding that the justifiable reliance standard applies to section 523(a)(2)(A) cases. Field v. Mans, 116 S. Ct. 437 (1995).
lenient than the reasonable reliance standard applied by the bankruptcy court, the Eleventh Circuit remanded the case for further fact finding on the issue of justifiable reliance.\textsuperscript{100}

Because section 523(a)(2)(A) provides the basis for one of the most common exceptions to a debtor's discharge, the Eleventh Circuit's decision in \textit{Vann} is rather significant. The case is particularly interesting, too, in that the Eleventh Circuit, which normally construes exceptions to discharge narrowly in favor of the debtor, adopted a lower standard of reliance that will make it easier for creditors to except debts from discharge.

\section*{C. Fraud: The Preclusive Effect of Prior Default Judgment}

One of the more significant bankruptcy cases decided by the Eleventh Circuit in 1995 was \textit{Bush v. Balfour Beatty Bahamas, Ltd. (In re Bush)}.\textsuperscript{101} The issue presented in that case was whether a default judgment based upon allegations of fraud could be used to conclusively establish the elements of fraud in a bankruptcy discharge proceeding.\textsuperscript{102} In 1989, Balfour filed a multicount complaint in federal district court, containing one count claiming fraud, against Freddie M. Bush.\textsuperscript{105} Bush answered the complaint, but after repeated failures on his part to comply with court orders and discovery requests, the district court entered default judgment on all counts, including the fraud claim, in favor of Balfour.\textsuperscript{106} Several months later, on November 7, 1991, Bush filed a Chapter 7 bankruptcy petition.\textsuperscript{106} An adversary proceeding ensued in which Balfour sought to have its judgment debt declared excepted from discharge under section 523(a)(2)(A) as a debt for money obtained by fraud.\textsuperscript{106} Balfour filed for summary judgment, arguing that the prior judgment had preclusive effect on the issue of fraud.\textsuperscript{107} Bush countered that there was no preclusive effect of the prior judgment because it had been entered by default.\textsuperscript{108} Both the bankruptcy and district courts concluded that the default judgment prevented Bush from denying fraud in the dischargeability proceeding.\textsuperscript{109}

\begin{itemize}
  \item \textsuperscript{100} 67 F.3d at 284.
  \item \textsuperscript{101} 62 F.3d 1319 (11th Cir. 1995).
  \item \textsuperscript{102} Id. at 1322.
  \item \textsuperscript{103} Id. at 1321.
  \item \textsuperscript{104} Id.
  \item \textsuperscript{105} Id. at 1322.
  \item \textsuperscript{106} Id.
  \item \textsuperscript{107} Id.
  \item \textsuperscript{108} Id.
  \item \textsuperscript{109} Id.
\end{itemize}
The basis of Bush’s argument before the Eleventh Circuit was that the issue of fraud was not actually litigated in the prior court proceeding because a default judgment had been entered.\footnote{Id.} In order for a previous judgment to have preclusive effect in a later proceeding, the issue in question must have been actually litigated.\footnote{Issue preclusion, traditionally known as collateral estoppel, requires the following elements: (1) the issue in the prior and present action must be identical; (2) the issue was actually litigated in the prior action; (3) the determination of the issue in the prior action was a critical and necessary part of the judgment in that litigation; and (4) the burden of persuasion in the present action must not be significantly heavier than the burden of persuasion in the prior action. Id. The only element at issue in \textit{Bush} was the second one, and there was no dispute that the other three elements had been satisfied.} The Eleventh Circuit noted that as a general matter, a default judgment will not support the application of issue preclusion precisely because the issue was not actually litigated.\footnote{62 F.3d at 1323.} This general rule, however, has its limits, as \textit{Bush} demonstrates. In Bush’s case, judgment by default was entered against him as a sanction for his failure to comply with court orders and discovery requests.\footnote{Id. at 1324. The district court in the prior litigation entered judgment by default against Bush under \textsc{Fed. R. Civ. P.} 37.} Unlike cases where default is entered for a party’s failure to make an appearance in a law suit, Bush actively participated in the prior action for an extended period of time.\footnote{62 F.3d at 1324.} Where a party substantially participated in an action in which he had a full and fair opportunity to defend on the merits, issue preclusion would apply to a later proceeding, even where the first action was concluded by a default judgment.\footnote{Id. at 1325.} Thus, the Eleventh Circuit prevented Bush from taking advantage of his misconduct in the prior court action through his efforts to frustrate and complicate the later bankruptcy dischargeability proceeding.

\textbf{D. Willful and Malicious Injury}

In \textit{Hope v. Walker (In re Walker)},\footnote{48 F.3d 1161 (11th Cir. 1995).} the Eleventh Circuit addressed the issue of an employer’s failure to obtain workers’ compensation insurance, concluding that such failure did not give rise to a willful and malicious injury.\footnote{Id. at 1164-65.} Frank Hope suffered a work related injury while in the employ of Keith Walker.\footnote{Id. at 1163.} Thereafter, Hope received an award of $27,939.41 from the Georgia State Board of Workers’ Compensation.
for his injuries. \textsuperscript{119} Unfortunately, Walker did not maintain workers' compensation insurance, \textsuperscript{120} and after paying only a fraction of the award, he filed for Chapter 7 bankruptcy. \textsuperscript{121} Hope commenced an adversary proceeding against Walker, arguing that his workers' compensation award should be declared nondischargeable under section 523(a)(6) of the Bankruptcy Code. \textsuperscript{122} The bankruptcy court ruled in favor of Walker by finding the debt dischargeable, and on appeal the district court affirmed. \textsuperscript{123}

The fact was undisputed that Walker willfully failed to procure workers' compensation insurance. \textsuperscript{124} Nevertheless, the critical issue for the court was whether an intentional and deliberate act could constitute a willful and malicious injury for the purposes of section 523(a)(6). \textsuperscript{125} The majority of the circuits have strictly construed the language of section 523(a)(6) to require that the debtor either intend the resulting injury or take intentional action that is substantially certain to cause an injury. Finding this majority view persuasive, the Eleventh Circuit stated as follows:

We follow our sister courts in concluding that, in order to be "willful" under section 523(a)(6), the debtor must have intended more than merely the act that results in injury. Congress has been very clear in expressing its intention in section 523(a)(6). The plain language of section 523(a)(6) excepts from discharge debts arising from "willful and malicious injury" rather than "willful and malicious acts which cause an injury . . . ." Mindful of our obligation to construe strictly exceptions to discharge in order to give effect to the fresh start policy of the Bankruptcy Code, . . . we hold that section 523(a)(6) requires a deliberate or intentional injury. \textsuperscript{126}

\textsuperscript{119} Id.
\textsuperscript{120} Id. Walker was required under Georgia law to maintain workers' compensation insurance for Hope who was a subcontractor. O.C.G.A. § 34-9-8 (1992). Nevertheless, he did not do so because he was under the mistaken impression that he was not the general contractor for the construction project and thought that Hope was responsible for securing his own insurance. 48 F.3d at 1163.
\textsuperscript{121} 48 F.3d at 1163.
\textsuperscript{122} 11 U.S.C. § 523(a)(6) (1993). Under this provision of the Bankruptcy Code, a discharge does not relieve the debtor of any debt "for willful and malicious injury by the debtor to another entity or to the property of another entity." Id.
\textsuperscript{123} 48 F.3d at 1163.
\textsuperscript{124} Id.
\textsuperscript{125} Id. at 1164.
\textsuperscript{126} Id. (quoting Eaves v. Hampel (In re Hampel), 110 B.R. 88, 93 (Bankr. M.D. Ga. 1990)).
Thus, the ultimate focus of a section 523(a)(6) willful and malicious inquiry is not the act that causes the injury, but the injury itself.

After clarifying that the intent requirement encompassed not only the desired consequences of an act but also the consequences that are substantially certain to result,27 the court in Walker turned to the facts of the case. In so doing, it concluded that the physical injury Hope suffered was not substantially certain to result from the failure of Walker to procure workers' compensation insurance.28 Walker's failure to have the insurance did not cause "an unbroken chain of events" that led to the actual injury suffered by Hope.29 At most, Walker's failure to obtain the insurance was an act of reckless disregard, but such conduct is insufficient for the purposes of section 523(a)(6).30 Prior to Walker, lower courts were in conflict over the application of section 523(a)(6) to the failure of a debtor to obtain workers' compensation insurance.31 Walker now settles this issue, at least within the Eleventh Circuit.

In Wolfson v. Equine Capital Corp. (In re Wolfson),32 the Eleventh Circuit concluded that a lender waived its right to bring a section 523(a)(6) discharge action for willful and malicious injury due to its failure to take reasonable steps to protect its collateral.33 Stephen P. Wolfson and his brother, Gary, were partners in a Florida horse farm, and Equine Capital Corporation was the farm's primary lender.34 As security for the various loans made by Equine Capital, the partnership pledged as collateral interests in the horses.35 In the course of its business, the partnership routinely deposited proceeds from the sale of collateralized horses into a general business account.36 The business paid to Equine Capital whatever it could on a monthly basis and added the remaining amounts due to the total indebtedness.37 Equine

127. Id. at 1165.
128. Id.
129. Id.
130. Id.
132. 56 F.3d 52 (11th Cir. 1995).
133. Id. at 54.
134. Id. at 53. The brothers entered into the loan transactions as general partners of the business and as individual co-makers. Id. at 53 n.1.
135. Id. at 53.
136. Id.
137. Id.
Capital was aware of this practice and continued extending credit to the partnership. After the partnership went into default, the collateral was sold, and Wolfson remained personally indebted to the lender for well over $5,000,000.

After Wolfson sought bankruptcy relief, Equine Capital commenced an adversary proceeding seeking to avoid the discharge of its claim. Equine Capital alleged that Wolfson converted to his own use the collateral and proceeds therefrom which had been pledged to the lender on account of the loans. The bankruptcy court ruled in favor of the creditor by concluding that Wolfson's retention of the proceeds from the collateralized horses was a willful and malicious act that caused an injury to Equine Capital. The district court affirmed.

On further appeal, the Eleventh Circuit reversed. In so doing, the court made clear that every act of conversion does not necessarily result in a willful and malicious injury. Instead, the underlying circumstances may reveal an honest, but mistaken, belief on the part of the debtor arising from the course of dealing between the parties which makes the debtor believe that his actions do not violate the creditor's rights. The course of dealing between Wolfson and Equine Capital clearly indicated that the lender was well aware of and acquiesced to Wolfson's business practice of depositing proceeds into the general business account. Despite this knowledge, Equine Capital continued to extend credit to Wolfson's partnership instead of exercising whatever rights it may have had regarding the disposition of the collateral. As a result, the Eleventh Circuit concluded that Equine Capital's "failure to take reasonable steps to protect its collateral" resulted in the waiver of its right to assert a claim for willful and malicious injury under section 523(a)(6). Thus, it was unnecessary to reach the question of whether Wolfson's conduct created a willful and malicious injury.

138. Id.
139. Id. at 53-54.
140. Id.
141. Id. at 54.
142. Id.
143. Id.
144. Id. at 55.
145. Id. at 54.
146. Id. (citing Davis v. Aetna Acceptance Co., 293 U.S. 328, 332 (1934)).
147. Id. at 54-55.
148. Id.
149. Id. at 55 (quoting Bank of Meeker v. McGinnis (In re McGinnis), 586 F.2d 162, 163 (10th Cir. 1978)).
150. Id. at 54.
E. Extension of Deadline for Filing Complaints

The question before the Eleventh Circuit in *Marshall v. Demos (In re Demos)*\(^{151}\) was whether a creditor was entitled to rely on the bankruptcy court's order granting the trustee's motion to extend time for filing complaints objecting to discharge and dischargeability of particular debts.\(^{152}\) After Menelaos P. Demos filed a Chapter 7 petition in bankruptcy, February 8, 1993, was set as the deadline for filing such complaints.\(^{153}\) Many creditors, however, wished to examine Demos pursuant to Bankruptcy Rule 2004\(^{154}\) prior to deciding whether or not to commence an adversary proceeding, and due to scheduling problems, all examinations would not be completed prior to the filing deadline.\(^{155}\) In view of these potential problems, the trustee sought and received from the bankruptcy court an extension of the deadline until March 15, 1993.\(^{156}\)

Arthur R. Marshall was a creditor of Demos, and he filed an adversary complaint on March 15, 1993.\(^{157}\) Despite having joined in the trustee's request for extension of time, Demos filed a motion to dismiss the complaint as being untimely, which the bankruptcy court granted.\(^{158}\) The bankruptcy court found that Marshall had not filed his own motion to extend time and concluded that he could not rely on the trustee's motion.\(^{159}\) After the district court affirmed and Marshall appealed, the Eleventh Circuit reversed.\(^{160}\) The court noted that the bankruptcy court granted the motion for an extension pursuant to its equitable powers under section 105 of the Bankruptcy Code.\(^{161}\) The powers provided to a bankruptcy court under this section are broad and include granting relief to a party who did not specifically bring the motion.\(^{162}\) Furthermore, the Eleventh Circuit found it entirely reasonable for Marshall to rely on the bankruptcy court's order. Specifically, the

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151. 57 F.3d 1037 (11th Cir. 1995).
152. Id.
153. Id. at 1038.
155. 57 F.3d at 1038.
156. Id.
157. Id.
158. Id.
159. Id. at 1038-39.
160. Id. at 1040.
161. 11 U.S.C. § 105 (1993). This provision grants the bankruptcy court broad powers to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title." Id.
162. 57 F.3d at 1039.
trustee’s motion to extend the time was served on Marshall, and by its plain meaning the extension of time was granted for all creditors.\textsuperscript{163} While a creditor may not rely upon an order “that clearly has nothing to do with him,”\textsuperscript{164} such was not the case with Marshall, and the Eleventh Circuit concluded that his complaint objecting to Demos’ discharge was timely filed.\textsuperscript{165}

\section*{F. Loss of Assets Prior to Bankruptcy}

The question of a debtor’s ability to satisfactorily explain the loss of assets was the issue addressed in \textit{Hawley v. Cement Industries, Inc. (In re Hawley)}.\textsuperscript{166} In 1989, Phillip E. Hawley signed a financial statement listing his total assets as \$13,822,477, total liabilities as \$1,876,814, and a resulting net worth of \$11,945,663.\textsuperscript{167} In 1990, however, Hawley filed a Chapter 7 bankruptcy petition in which he claimed less than \$20,000 in assets.\textsuperscript{168} Cement Industries, one of Hawley’s creditors, soon filed an adversary proceeding under section 727(a)(5) of the Bankruptcy Code,\textsuperscript{169} urging the bankruptcy court to deny Hawley’s discharge based upon his failure to adequately explain the significant loss of assets between the 1989 financial statement and the 1990 bankruptcy petition.\textsuperscript{170}

At the hearing before the bankruptcy court, Hawley testified that he had worked for several years as a mortgage broker, preparing well over one hundred financial statements during his lifetime.\textsuperscript{171} As a result of financial problems in the late 1980s, Hawley had to liquidate many of his assets, but he kept no records of these transactions.\textsuperscript{172} Furthermore, he testified that not all the values he had provided on the finance statements were correct.\textsuperscript{173} After considering this evidence, the

\begin{itemize}
\item \textsuperscript{163} Id. at 1039-40.
\item \textsuperscript{164} Id. at 1039.
\item \textsuperscript{165} Id. at 1039-40.
\item \textsuperscript{166} 51 F.3d 246 (11th Cir. 1995) (per curiam).
\item \textsuperscript{167} Id. at 247.
\item \textsuperscript{168} Id.
\item \textsuperscript{169} 11 U.S.C. \textsuperscript{1172} § 727(a)(5) (1993). According to this provision, the bankruptcy court shall grant the debtor a discharge unless “the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor’s liabilities." Id.
\item \textsuperscript{170} 51 F.3d at 247.
\item \textsuperscript{171} Id. at 248.
\item \textsuperscript{172} Id.
\item \textsuperscript{173} Id.
bankruptcy court ruled in favor of Cement Industries by denying Hawley’s discharge, and the district court affirmed.\textsuperscript{174} On appeal to the Eleventh Circuit, Hawley first argued that Cement Industries’ failure to question him about the loss of assets prior to commencing the adversary proceeding barred it from objecting to his discharge.\textsuperscript{175} The court rejected this position after finding no language in section 727(a)(5) explicitly requiring a creditor to call upon the debtor to explain the loss of assets before filing a complaint.\textsuperscript{176} Next, Hawley claimed that Cement Industries failed to carry its burden of proving its objection to his discharge.\textsuperscript{177} The court disagreed and found that Cement Industries met its burden by showing the “vast discrepancies” between Hawley’s 1989 financial statement and his 1990 bankruptcy petition.\textsuperscript{178} Once Cement Industries made this showing, the burden shifted to Hawley to satisfactorily explain the loss.\textsuperscript{179} The bankruptcy court found Hawley’s testimony and lack of documentation unconvincing on the issue, and that such a finding was not clearly erroneous.\textsuperscript{180} For this reason, the Eleventh Circuit affirmed.\textsuperscript{181}

The Eleventh Circuit’s decision should come as no surprise, but its discussion of the burden of proof is significant. Much is made of the burden a creditor carries in objecting to a debtor’s discharge, as bankruptcy is a debtor’s remedy. As demonstrated in Hawley, such a burden may be minimal at best within the context of section 727(a)(5). Thus, the fact that creditors carry the initial burden should not discourage creditors from raising the objection.

VI. CONFIRMATION

A. Chapter 11 Good Faith Requirement

In McCormick v. Banc One Leasing Corp. (In re McCormick),\textsuperscript{182} the Eleventh Circuit concluded that a debtor’s assertion of his Fifth Amendment\textsuperscript{183} privilege in a related adversary proceeding was not

\begin{footnotesize}
\begin{enumerate}
\item Id.
\item Id.
\item Id.
\item Id. at 249.
\item Id.
\item Id. (citing In re Chalick, 748 F.2d 616, 619 (11th Cir. 1984)).
\item Id. Because the bankruptcy court’s ruling was a finding of fact, it could not be overturned on appeal unless found to be clearly erroneous. Id. at 248.
\item Id. at 249.
\item 49 F.3d 1524 (11th Cir. 1995) (per curiam).
\item U.S. CONST. amend. V.
\end{enumerate}
\end{footnotesize}
sufficient grounds on which to deny confirmation of his Chapter 11 plan for lack of good faith.\textsuperscript{184}

During the course of Timothy McCormick's bankruptcy case, a creditor filed an adversary proceeding against him seeking to declare a debt nondischargeable.\textsuperscript{185} In a deposition related to the adversary, McCormick refused to testify by asserting his Fifth Amendment privilege against self-incrimination.\textsuperscript{186} Sometime thereafter, several creditors filed objections in the bankruptcy case to McCormick's plan, claiming that it failed to satisfy the good faith requirement of section 1129(a)(3) of the Bankruptcy Code.\textsuperscript{187} Yet the only reason cited for the objection was McCormick's assertion of his Fifth Amendment privilege.\textsuperscript{188} The bankruptcy court sustained the objections by concluding that a debtor's failure to testify was contrary to the goals of the Bankruptcy Code, and the district court affirmed.\textsuperscript{189}

On further appeal, the Eleventh Circuit stated that "[w]here the plan is proposed with the legitimate and honest purpose to reorganize and has a reasonable hope of success, the good faith requirements . . . are satisfied."\textsuperscript{190} The focus of a court's inquiry at the time of confirmation is the plan itself, which requires the court to consider the circumstances surrounding the plan while keeping in mind bankruptcy's purpose of providing a debtor the opportunity to make a fresh start.\textsuperscript{191} The circumstances surrounding McCormick's proposed plan failed to suggest the existence of any bad faith, with the exception of his failure to testify in a related adversary proceeding.\textsuperscript{192} In fact, McCormick had complied with all the necessary financial and disclosure requirements of Chapter 11.\textsuperscript{193} The court then pointed out that nothing in the Bankruptcy Code or the case law allowed the denial of confirmation solely on the grounds

\textsuperscript{184} 49 F.3d at 1525-26.
\textsuperscript{185} Id. at 1526.
\textsuperscript{186} Id. It is not clear from the Eleventh Circuit's opinion what the facts were underlying the adversary proceeding or the reasons for McCormick's invocation of the Fifth Amendment privilege.
\textsuperscript{187} Id.; 11 U.S.C. § 1129(a)(3) (1993). According to section 1129(a), the bankruptcy court shall confirm the Chapter 11 plan if certain requirements are met, including if the "plan has been proposed in good faith and not by any means forbidden by law." Id.
\textsuperscript{188} 49 F.3d at 1527.
\textsuperscript{189} Id.
\textsuperscript{190} Id. at 1526.
\textsuperscript{191} Id.
\textsuperscript{192} Id.
\textsuperscript{193} Id. For example, McCormick filed all the schedules and statements of financial affairs and testified at the meeting of creditors. The bankruptcy court approved his disclosure statement, and McCormick secured the necessary number of ballots by creditors favoring the plan. Id.
of a debtor’s refusal to testify in a related proceeding on Fifth Amend-
ment grounds. In view of these facts, the Eleventh Circuit conclud-
ed that McCormick’s refusal to testify cannot itself be the basis for
denying confirmation of his plan so long as his conduct did not impede
the basic administration of his bankruptcy case.

B. Mootness and Chapter 13 Confirmation

The question presented to the Eleventh Circuit in Russo v. Seidler (In
re Seidler) was whether an appeal from a bankruptcy court order in
an adversary proceeding removing a purchase money mortgage holder’s
lien was rendered moot by confirmation of the debtor’s Chapter 13
plan.

Thomas and Dorothy Russo filed a claim against Marion Seidler in his
bankruptcy case for amounts Seidler allegedly owed them on a purchase
money mortgage on a home in New York. Seidler, however, disput-
ed the validity of the Russos’ mortgage lien. The bankruptcy court
found that the lien had already been satisfied, and the Russos appealed
to the district court. After doing so, they obtained an order granting
a stay of confirmation of Seidler’s Chapter 13 plan pending the
appeal. The stay, however, was conditioned upon the Russos’
posting of a $50,000 bond; when they failed to do so, the bankruptcy
court confirmed the plan. Then, on Seidler’s motion, the district
court dismissed the appeal upon the conclusion that the issues were
moot in view of confirmation.

The central finding of mootness is a determination that effective
judicial relief is no longer available. Thus, the issue framed before
the Eleventh Circuit was whether the Russos had available to them
effective judicial relief notwithstanding plan confirmation should they
prevail on the merits of their appeal. In dismissing the appeal, the

194. Id.
195. Id. at 1527.
196. 44 F.3d 945 (11th Cir. 1995).
197. Id. at 946.
198. Id.
199. Id.
200. Id. at 946-47.
201. Id. at 947.
202. Id.
203. Id.
204. Id.
205. Id.
district court relied upon section 1327 of the Bankruptcy Code to conclude that the Russos were bound by the terms of the confirmed Chapter 13 plan which made no provisions for the treatment of their claim. The Eleventh Circuit agreed that under section 1327, a confirmed plan has res judicata effect on certain issues, but this view applied only to issues "which were or should have been addressed in the confirmation process." There was no authority in either the case law or the Bankruptcy Code to lend credence to the idea that confirmation would moot an appeal of issues that were not decided within the context of confirmation.

The dispute between Seidler and the Russos pertained to whether Seidler had satisfied the purchase money mortgage lien on his home, and confirmation did not address this question. Should the Russos prevail on the merits of their case, the Eleventh Circuit noted that they would be able to enforce their lien against Seidler's property. Thus, relief remained available to the Russos, thereby causing their appeal to continue to be justiciable.

VII. JURISDICTION

A. Bankruptcy Court Jurisdiction

A bankruptcy court's jurisdiction was at issue when the Eleventh Circuit decided Community Bank of Homestead v. Boone (In re Boone). Daniel and Sara Boone were individually liable to Community Bank of Homestead for business and home loans totalling close to $100,000. In 1989, they contracted to sell their house for $91,000 and then immediately filed for bankruptcy. After their petition, but before closing on the house, Community Bank sent the closing agent two estoppel letters claiming an excess of $97,000 of the proceeds from the impending sale. Because it appeared to the Boones after these

206. 11 U.S.C. § 1327 (1993). According to this statute, the "provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan." Id.
207. 44 F.3d at 947-48.
208. Id. at 948.
209. Id.
210. Id. at 949.
211. Id.
212. 52 F.3d 958 (11th Cir. 1995).
213. Id. at 959.
214. Id.
215. Id.
letters that they would receive no proceeds from the sale, they refused to complete the closing. Nevertheless, they brought an adversary proceeding against Community Bank alleging tortious interference with contract regarding the sale of the house. The bankruptcy court awarded the Boones $10,199 in actual damages and $30,596 in punitive damages, and the district court affirmed on appeal.

On further appeal, the Eleventh Circuit disposed of the case on jurisdictional grounds. For federal bankruptcy jurisdiction to exist, a case must at a minimum "relate to" a case under Title 11. A civil proceeding is related to a case under Title 11 if

the outcome of the proceeding could conceivably have an effect on the estate being administered in bankruptcy . . . . An action is related to bankruptcy if the outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate.

Even under this broad definition of bankruptcy jurisdiction, the Eleventh Circuit concluded that the Boones' claim against Community Bank did not relate to its bankruptcy case. The conduct that gave rise to their claim arose after they filed their petition in bankruptcy, so any damages they received would belong solely to them and not be included in estate property. Furthermore, the Boones' claim against Community Bank was not a core proceeding over which federal bankruptcy jurisdiction would exist. The existence of common issues of fact between the tortious interference claim and the other bankruptcy related claims was no justification in itself to make the matter a core proceeding. Also, the mere fact that the Boones were debtors in bankruptcy

216. Id.
217. Id. at 960. The Boones' adversary also sought a determination of the extent of Community Bank's lien on the house and an order compelling the Bank to accept that amount in satisfaction of the lien. Id.
219. 52 F.3d at 960 (quoting 28 U.S.C. § 1334(b) (1993)).
220. Id. (quoting Miller v. Kemira, Inc. (In re Lemco Gypsum, Inc.), 910 F.2d 784, 788 (11th Cir. 1990), quoting Pacor, Inc. v. Higgins, 743 F.2d 984, 994 (3d Cir. 1984)).
221. Id.
222. Id.
224. 52 F.3d at 961 (citing Miller v. Kemira, Inc. (In re Lemco Gypsum, Inc.), 910 F.2d 784, 789 (11th Cir. 1990)).
did not make their claim a core proceeding. Thus, the Eleventh Circuit dismissed the case for want of jurisdiction.

Boone certainly is an important case that defines federal bankruptcy jurisdiction. While bankruptcy's core and "related to" jurisdiction are very broad in scope, Boone makes it clear that bankruptcy is not a clearinghouse for any and all claims that a debtor may have.

B. Appellate Jurisdiction

Appellate court jurisdiction was at issue in Lockwood v. Snookies, Inc. (In re F.D.R. Hickory House, Inc.). Plaintiff Bryan Lockwood incorporated the debtor, F.D.R. Hickory House, Inc., for the purpose of purchasing several restaurants in Georgia from the defendants, Snookies, Inc., and others. After the sale, however, Snookies brought a state court fraud and conversion action against F.D.R. Hickory House, Lockwood, and others, eventually winning a $16,000,000 judgment. At some time after the commencement of the state court action but prior to the entry of judgment, F.D.R. Hickory House filed for bankruptcy. After entry of the judgment, the bankruptcy trustee signed a proposed settlement and release agreement with Lockwood to settle all possible claims of the debtor against Lockwood. The agreement, however, purported to enjoin Snookies and all the other state court plaintiffs from enforcing their $16,000,000 judgment against Lockwood. Upon the objection of Snookies, the bankruptcy court refused to approve the settlement agreement, because it would enjoin enforcement of claims that were not part of the debtor's estate. The district court affirmed.

When Lockwood appealed further, the Eleventh Circuit disposed of the case on procedural grounds rather than making a decision on the merits. The court initially noted that its appellate jurisdiction was limited to only final judgments and orders entered by the district court.
A final decision "is one which ends the litigation on the merits and leaves nothing for the court to do but execute the judgment." The Eleventh Circuit panel concluded that the district court's refusal to approve the settlement agreement was not a final order, because it did not settle the issue of the potential liabilities between Lockwood and F.D.R. Hickory House.

VIII. THE TRUSTEE'S RECOVERY POWERS: RATE UNDERCHARGE CLAIMS

In Whitaker v. Power Brake Supply, Inc. (In re Olympia Holding Corp.), the Eleventh Circuit concluded that the Negotiated Rates Act of 1993 barred a bankruptcy trustee's undercharge claim against a shipper. The NRA provides relief to shippers facing these claims by exempting small business from undercharge liability. The trustee argued that this exemption was precluded from application in bankruptcy by virtue of sections 363(1) and 541(c)(1) of the Bankruptcy Code. Through section 363(1), the Bankruptcy Code renders unenforceable laws that limit a trustee's right to use, sell or lease estate property because of the debtor's financial condition. Furthermore, section 541(c)(1)
prohibits the enforcement of laws that would prevent property from becoming part of the estate in bankruptcy due to the debtor's financial condition. In contrast, the NRA operates to insulate shippers from liability in cases where the interstate carrier is no longer transporting property. According to the trustee, the “no longer transporting property” language of the NRA prefaces the applicability of its provisions upon the interstate carrier’s financial condition.

The Eleventh Circuit rejected the trustee’s argument for two reasons. First, the court concluded that the application of the NRA is not contingent on the debtor’s financial condition. The language regarding a carrier that “is no longer transporting property” is a reference to the carrier’s operational status which is distinct from the carrier’s financial condition. Therefore, sections 363(l) and 541(c)(1) of the Bankruptcy Code do not prevent the application of the NRA to insulate a shipper from undercharge liability. Second, the court pointed out that the application of the small business defense upon which the shipper relied in this case is not conditioned upon the carrier’s operational status. While other exceptions found in the NRA require the shipper to show that the carrier is no longer transporting property, the small business exception contains no such requirement. Therefore, the Eleventh Circuit concluded that the NRA properly barred the trustee’s undercharge claim. This decision is significant in that it should dispose of the many rate undercharge claims that have clogged federal courts in Alabama, Florida, and Georgia for the better part of this decade.

245. Id. (citing 11 U.S.C. § 541(c)(1)).
246. Id. (citing 49 U.S.C. § 10701(f)(1)).
247. 68 F.3d at 1306-07.
248. Id. at 1307-08.
249. Id. at 1308.
250. Id. at 1309.
251. Id. at 1308.
252. Id.
IX. SANCTIONS

In the case of *Glatter v. Mroz (In re Mroz)*, the Eleventh Circuit issued an important decision on the question of Rule 9011 sanctions. The bankruptcy court imposed sanctions against the trustee’s law firm and one of its associates in favor of the ex-wife of the debtor David G. Mroz. The trustee filed a preference avoidance complaint against Mroz’s former spouse, but the bankruptcy court later dismissed it. After dismissing the action, the court imposed sanctions because the trustee proceeded to trial on the basis of a simple affidavit which did not identify the date of the alleged transfer, the debt the transfer was to repay, or the manner in which the transfer was made. Also, the bankruptcy court was bothered by the fact that for two and a half years after the trustee filed the complaint, no attempts were made to discover any additional evidence to support the allegations contained therein. After the district court affirmed the sanctions, the trustee’s law firm appealed to the Eleventh Circuit which reversed and remanded the case.

Rule 9011 authorizes sanctions “when (1) the papers are frivolous, legally unreasonable or without factual foundation, or (2) the pleading is filed in bad faith or for an improper purpose.” The issue before the Eleventh Circuit in *Mroz* was whether the trustee’s complaint was legally unreasonable and without factual foundation, because it was based on the debtor’s simple affidavit. The court noted that its focus under Rule 9011 is what was known by the signing attorney at the time the complaint was filed. Prior to commencing the preference action, the trustee had several discussions with his counsel and the debtor about the alleged preferential transfers. Under penalty of perjury, the debtor prepared an affidavit containing factual allegations which, if true, would establish the necessary elements of a preferential transfer.

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254. 65 F.3d 1567 (11th Cir. 1995).
255. FED. R. BANKR. P. 9011 (Supp. 1996). Because the language of Rule 9011 closely follows the language of FED. R. CIV. P. 11, the Eleventh Circuit’s decision in *Mroz* has significant implications in all civil cases.
256. 65 F.3d at 1571.
257. Id. at 1570-71.
258. Id. at 1571.
259. Id.
260. Id. at 1576-77.
261. Id. at 1572.
262. Id.
263. Id. at 1573.
264. Id. at 1573-74.
to the debtor's ex-wife. The Eleventh Circuit concluded that even though this information may have been insufficient to succeed at trial, it was sufficient to meet the requirements of Rule 9011 and warrant the filing of the complaint. Consequently, the trustee's complaint against the debtor's former wife was reasonably interposed, and the bankruptcy court's sanctions were improper.

While concluding that the trustee's attorneys met the low threshold requirements of Rule 9011, the Eleventh Circuit's inquiry did not end there. It continued by recognizing a bankruptcy court's inherent power to impose sanctions outside of Rule 9011. In order to exercise its inherent power and impose sanctions, however, the bankruptcy court would have to make a finding of subjective bad faith. At issue in Mroz was the lack of action on the part of the trustee and his law firm once the preference complaint was filed. If the trustee's postfiling conduct was made in bad faith, the sanctions would be justified. Nevertheless, the accused parties were entitled to due process, which required fair notice that the conduct may warrant sanctions, and the opportunity to respond either orally or in writing to justify the conduct in question. Because the bankruptcy court had not afforded the trustee and his law firm an opportunity to defend their conduct, the Eleventh Circuit remanded the case for an evidentiary hearing to determine if the parties had acted in bad faith.

265. Id. at 1574. For the elements of a preferential transfer, see 11 U.S.C. § 547(b) (1993).
266. Id.
267. Id.
268. Id.
269. Id. at 1575.
270. Id. at 1576.
271. Id.
272. Id. at 1575-76.
273. Id. at 1576-77.